

Wisconsin State Legislature

SENATE CHAIR
ALBERTA DARLING

317 East, State Capitol
P.O. Box 7882
Madison, WI 53707-7882
Phone: (608) 266-5830



ASSEMBLY CHAIR
ROBIN VOS

309 East, State Capitol
P.O. Box 8593
Madison, WI 53708-8953
Phone: (608) 266-9171

Joint Committee on Finance *100TH ANNIVERSARY 1911 - 2011*

MEMORANDUM

To: Members
Joint Committee on Finance

From: Senator Alberta Darling
Representative Robin Vos

Date: February 28, 2011

Re: 14-Day Passive Review Approval – DOR

Pursuant to s. 565.02(7), Stats., attached is a 14-day passive review request from the Department of Revenue, received on February 28, 2011.

Please review the material and notify **Senator Darling** or **Representative Vos** no later than **Thursday, March 17, 2011** if you have any concerns about the request or if you would like the Committee to meet formally to consider it.

Also, please contact us if you need further information.

Attachments

AB:RV;jm



State of Wisconsin • DEPARTMENT OF REVENUE

2135 RIMROCK ROAD • Mail Stop 624A • P.O. BOX 8933 • MADISON, WISCONSIN 53708-8933 • 608-266-6466 • FAX (608) 266-5718
<http://www.revenue.wi.gov>

Scott Walker
Governor

Richard G. Chandler
Secretary of Revenue

February 28, 2011

The Honorable Alberta Darling, Co-Chair
Member, Joint Committee on Finance
317 East, State Capitol
Madison, WI 53708

The Honorable Robin Vos, Co-Chair
Member, Joint Committee on Finance
309 East, State Capitol
Madison, WI 53708

RECEIVED
FEB 28 2011

BY: *J. Finance*

Dear Senator Darling and Representative Vos:

Section 565.02(7), Wis. Stats., requires a report to the Joint Committee on Finance every March 1, containing the following information:

- A. An estimate of lottery ticket sales and prize payment for the current and subsequent fiscal year;
- B. The prize payout percentages for each type of lottery game offered; and
- C. The Lottery's evaluation of the impact that prize payout ratios are likely to have upon ticket sales and operating costs, and upon the Lottery's constitutionally mandated mission to maximize revenue for property tax relief in Wisconsin.

The report, which is attached, recommends slight changes to prize payouts. The Lottery projects a prize payout of 58.67% for FY 11 and a payout of 58.66% for FY 12.

Please feel free to contact me should you have any questions.

Sincerely,

Richard G. Chandler

Richard G. Chandler
Secretary of Revenue

Enclosure

Lottery Sales and Prize Payout

Report to the Joint Committee on Finance

Wisconsin Department of Revenue
Lottery Division

February 28, 2011



EXECUTIVE SUMMARY

The Wisconsin Lottery's mission is to provide the greatest possible property tax relief to Wisconsin homeowners by offering entertaining games while operating with security, integrity and social responsibility. Since its inception, the Lottery has generated \$3.08 billion in property tax relief for Wisconsin homeowners, \$582 million in commissions for Wisconsin businesses and more than \$5.53 billion in prizes for players.

In accordance with sec. 565.02(7), Wis. Stats., the Department of Revenue, Lottery Division, submits this report, detailing the following:

- An estimate of ticket sales and prize payment for the current and subsequent fiscal year.
- The prize payout percentages for each type of lottery game offered.
- The Lottery's evaluation of the impact that prize payout ratios are likely to have upon ticket sales and operating costs, and upon the Lottery's constitutionally-mandated mission to maximize revenue for property tax relief in Wisconsin.

Sales Overview

The economic recession has had an impact on Lottery sales, although not as much as it has on other sectors of the economy. In Fiscal Year 2008, sales were \$494.7 million. Sales dropped to \$473.4 million in FY 09 and increased 1.5% to \$480.9 million in FY 10. While not recession-proof, the Lottery appears recession-resistant; its sales outlook and its ability to generate funds for property tax relief remain strong.

Fiscal Year 2011. The Lottery projects that gross revenues will remain stable at \$480.1 million.¹

Fiscal Year 2012. Stable sales are also projected for FY 12. Gross revenues are projected to be \$480.4 million.

The Lottery is engaged in a long-term growth strategy for instant scratch sales by meeting consumer demand for more games at higher price points. Sales continue to be strong for tickets priced at \$5 and higher.

The most significant factor affecting Lottery lotto game² sales is the frequency of large jackpots for the multi-state Powerball and Mega Millions games. Jackpot game sales are notoriously difficult to sustain over time—even one year to the next—because of the random occurrence of these jackpots. A range can be established to forecast future performance based upon past performance, but that range is broad, and jackpot game sales from year to year can be tens of millions of dollars different from estimates.

The Lottery continues to maintain sales of its daily lotto games by developing strategic, short-term enhancements to them. The Lottery has observed a positive sales “halo effect” from limited time offers and anticipates relatively stable sales in daily lotto games as a result.

¹ This is the amount certified in October 2010 for the purpose of establishing the Lottery Property Tax Credit. However, Lottery sales were up 3% year-to-date as of February 1, 2011.

² Lotto games are games in which tickets are produced from a retailer's terminal (e.g. Powerball, Badger 5). The Internet has made the use of the historical term “on-line” in reference to lottery games confusing, as some incorrectly believe the games are available via the Internet. Hence, the use of “lotto”.



Prize Payout Ratios

The prize payout percentage is the amount of Lottery revenue that is returned to players in the form of prizes. Each individual game has a unique prize structure that represents the number and value of its prizes and the odds of winning those prizes. In FY 10 the prize payout ratio was 56.76%. In FY 09 the Lottery's prize payout ratio was 59.12%; the national average was 60.7%.³

Fiscal Year 2011. The Lottery expects to pay \$281.6 million in prizes. Total prize payout for all Lottery games is estimated to be 58.67%.

Fiscal Year 2012. With increased sales projected, the Lottery expects to pay \$281.8 million in prizes. Total prize payout is estimated to be 58.66%.

Prize Payout Impact

Although the prize payout has increased in recent years, there has been no negative effect on the Lottery's contribution to property tax relief. In FY 02, the prize payout was 56.61%; sales were \$427.6 million. Last year the prize payout was 56.76%; sales were \$480.9 million.

Increasing the prize payout in recent years has had no significant impact on Lottery expenses. The Lottery's costs remain low. Operating expenses were \$32,077,069 (estimated) in FY 10, a decrease from the previous year. The FY 10 costs were 6.6% of sales, well below the 10% cap set by state statute. Moreover, the Wisconsin Lottery continues to be one of the most efficient lotteries in the country, with the nation's sixth lowest per capita expenses (Exhibit 1).

Conclusion and Recommendation

Lottery ticket sales will remain flat in FY 11, as the impact of the economic downturn continues.

For FY 12, the Lottery has designed an overall prize payout of 58.66%, which is in line with the projected payout of 58.67% in FY 11 and above the lower payout of 56.78% in FY 10.

Increasing the prize payout in recent years has had no significant impact on Lottery expenses. The Lottery continues to be conservative in its use of prize payouts and will achieve its sales goals with only slight adjustments to its current prize payout percentages. Instant game prize payout, which was increased to sustain the successful higher price point strategy at the \$10 and \$20 levels, will be maintained. Total lotto game prize payout will also be maintained at current levels.

³ LaFleur's 2010 World Lottery Almanac. FY 09 is the latest year for which national prize payout averages are available.



WISCONSIN LOTTERY PRIZE PAYOUT REPORT 2011

LOTTERY SALES

Lottery sales were \$480.9 million in FY 10, an increase of 1.5% from the previous year.

Gross revenues for FY 11 are expected to remain stable at \$480.1 million. Flat sales are also anticipated for FY 12, with current estimates at \$480.4 million.

Sales by game type for the past three years and projected sales for the next two years are shown on Table 1.

Table 1. Ticket Sales by Fiscal Year and Game Type*

Game Type	FY 08 Sales Audited	FY 09 Sales Unaudited	FY 10 Sales Unaudited	FY 11 Sales Projection	FY 12 Sales Projection
Instant Scratch	\$284,255,001	\$271,901,512	\$269,371,319	\$270,600,000	\$270,600,000
Pulltab	\$3,174,284	\$4,896,196	\$3,900,351	\$4,000,000	\$4,000,000
Lotto	\$207,297,783	\$196,616,546	\$207,670,334	\$205,458,122	\$205,785,673
Total	\$494,727,068	\$473,414,254	\$480,942,004	\$480,058,122	\$480,385,673

Source: Wisconsin Lottery FY 2010 Stand Alone Financial Statements, rounded to the nearest dollar.

TOTAL PRIZE PAYOUT AND PRIZES PAID OR EXPECTED TO BE PAID

Wisconsin law requires that at least 50% of Lottery gross sales be returned to players as prize payments (sec. 25.75(3)(a), Wis. Stats). In FY 10, 56.76% of Lottery gross sales were returned to players as prize payments. FY 10 payout was relatively low when compared to other recent years. The Lottery estimates that its total prize payout for all products in FY 11 will increase to 58.67%, which is closer to the average for the last five years.

In FY 12, the Lottery's prize payout for all game categories is projected to dip slightly from FY 11 to 58.66%. The prize payout for Wisconsin Lottery games will remain below the industry averages.

Scratch Ticket Prize Payout

The actual percentage of prizes paid for individual scratch games may be more or less than the planned payout. This can occur when sales of a particular game are discontinued before all the tickets are sold, as is done when the last top prize is claimed. Sales of games with drawing prizes may also accrue in one fiscal year, while the prizes are drawn and awarded in the following year. Finally, unclaimed prizes may be credited after the year in which the prize expense was accrued.



The Lottery has designed its scratch games to achieve a payout of 64.88% in FY 11 and anticipates the same payout for FY 12. This payout percentage will allow the Lottery to continue its strategy of offering an expanded variety of higher price point tickets. The success of \$20, \$15 and \$10 scratch games has demonstrated the benefits of such a strategy. The \$10, \$15 and \$20 scratch products accounted for 25% of scratch sales in FY 10, up from 20% in FY 08 and 23% in FY 09.

The Lottery's scratch product prize payout was 63.25% in FY 10, 1.63% lower than projected in the 2010 Prize Payout Report. As was the case in FY 09, the lower than anticipated payout was due to the end of Guaranteed Low End Prize Structure (GLEPS) discounting of instant games to retailers⁴. As noted in the 2010 report, the cost of GLEPS prizes used to be discounted from the cost of a pack of tickets. They were accounted for as paid. Beginning in January 2008, the Lottery no longer discounted GLEPS prizes. The gap between the projected and actual percentage was larger because FY 10 was the first full year to be fully impacted by the end of GLEPS discounting (tickets sold under GLEPS discounting were still redeemable in FY 09).

The end of GLEPS discounting has benefited the Lottery and, by extension, Wisconsin homeowners. Unclaimed GLEPS prizes are now credited to the Lottery, reducing expenses and increasing profits. However, the move away from GLEPS discounting makes it more difficult to estimate prize payouts. A more detailed discussion of how the end of GLEPS discounting has affected the prize payout and profits can be found in Appendix A.

The Lottery estimates that the trend towards stronger sales of high price point (higher prize payout) games combined with the savings due to the discontinuation of GLEPS discounting will allow the Lottery to stay within the 64.88% prize payout.

Pulltab Prize Payout

Prize payout for pulltab tickets averaged 62.82% in FY 10. This was an increase from previous years due to the addition of an 80% payout game. Payout rates are expected to increase to 63.46% in FY 11 as games with higher than 62.82% are added to the overall mix.

Lotto Prize Payout

It is difficult to project the prize payout of lotto games because, unlike scratch and pulltab games, they normally do not have a predetermined number of winners. The number of winners and the amount of the prizes won occur randomly. The overall lotto game payout is anticipated to be 50.39% for FY 11 and FY 12.

The average prize payout percentages by game type for the past three years and the estimated prize payout percentages for the next two fiscal years are shown in Table 2. A weighted average is used to accurately reflect the performance of games with higher sales.

⁴ Guaranteed low end prizes were prizes under \$50.



Table 2. Weighted Average Prize Payout Percentages by Fiscal Year and by Game Type*
(Percentages are rounded)

Game Type	FY 087 Prize Payout	FY 09 Prize Payout	FY 10 Prize Payout	FY 11 Prize Payout (Estimated)	FY 12 Prize Payout (Estimated)
Instant Scratch	64.76%	64.33%	63.25%	64.88%	64.88%
Pulltab	63.43%	62.17%	62.82%	63.46%	63.46%
Lotto	48.38%	51.76%	48.23%	50.39%	50.39%
Total	57.89%	59.12%	56.76%	58.67%	58.66%

*Source: Wisconsin Lottery FY 2010 Stand Alone Financial Statements, rounded to the nearest dollar

Table 3 shows prizes paid during the past three fiscal years and prizes expected to be paid in the next two fiscal years. Prizes expected to be paid in FY 11 and FY 12 are calculated by multiplying the sales projection for each game by its prize payout percentage.

Table 3. Prizes Paid or Expected to be Paid by Fiscal Year and by Game Type*

Game Type	FY 08** Prizes Paid (Audited)	FY 09 Prizes Paid (Unaudited)	FY 10 Prizes Paid (Unaudited)	FY 11 Projected Prizes	FY 12 Projected Prizes
Instant Scratch	\$184,088,185	\$174,922,499	\$170,381,896	\$175,565,280	\$175,565,280
Pulltab	\$2,014,513	\$3,043,774	\$2,450,287	\$2,538,400	\$2,538,400
Lotto	\$100,309,477	\$101,918,329	\$100,155,657	\$103,530,348	\$103,695,401
Total***	\$286,412,175	\$279,884,602	\$272,987,839	\$281,634,028	\$281,799,081

*Source: Wisconsin Lottery FY 2010 Stand Alone Financial Statements, rounded to the nearest dollar.

**Prize amounts shown are based upon the accrual method. The accrual method reflects prizes as they are paid out to the players and is consistent with generally accepted accounting principles (GAAP).

***Projected totals for FY 11 and FY 12 are the amounts certified in October 2010.



PRIZE PAYOUT IMPACT ON REVENUES, EXPENSES AND PROPERTY TAX RELIEF

Setting the proper prize payout is complicated. Set the payout too low and players will not play. (This is especially true at the higher price points where players demand a greater reward for the risk they take.) Set the payout too high and lower profits may result. The Lottery has been very conservative in its use of prize payout to drive sales, with positive results. In FY 02 the prize payout was 56.61%; in FY 10 it was 56.76%. During the same period, sales rose from \$427.6 million to \$480.9 million. Net operating income went from \$121.8 million to \$143.8 million (estimated). The Lottery carefully manages payout to maximize net operating income.

Instant Scratch Market Trends and Prize Payout

The economic recession that persisted through much of FY 09 and FY 10 has had an impact on scratch games sales. Sales in FY 10 were \$269.4 million, down 5.2% from the highs reached in FY 08. There are signs of reversal in FY 11, with year-to-date scratch game sales up 7% from FY 10 levels at \$141.8 million, through the end of the second quarter of FY 11. The Lottery expects instant sales to reach \$270.6 million in FY 11.

The Lottery has been able to generate increases in instant scratch sales in recent years by responding to consumer demands for higher price point tickets with higher top prizes, better overall odds of winning and a higher payout. Players see increased entertainment value in a higher risk-reward proposition. This strategy is consistent with the industry strategy of offering more in prizes as a player risks more in the purchase price of a ticket. The table below depicts the shift in sales from lower priced tickets to higher priced tickets. In FY 10, 24.9% of scratch sales occurred at \$10 and up, compared to 18.5% in FY 07. In addition to successfully positioning higher price point games, the Lottery continues to maintain a strong market presence at the \$2 and \$3 price points (Table 4).

Table 4. Percentage of Total Net Sales by Price Point

Price Point	FY 07 % of Total Net Sales	FY 08 % of Total Net Sales	FY 09 - % of Total Net Sales	FY10 - % of Total Net Sales	FY11 YTD - % of Total Net Sales**
\$1	13.8%	11.5%	11.1%	10.6%	9.5%
\$2	25.2%	23.0%	21.9%	22.1%	22.2%
\$3	15.8%	16.8%	14.9%	15.7%	14.4%
\$5	26.7%	28.9%	28.9%	26.7%	25.7%
\$10	8.8%	9.7%	11.8%	13.2%	14.0%
\$15	--	--	1.5%*	1.6%*	2.9%*
\$20	9.7%	10.2%	9.8%	10.1%	11.3%

Note: Percentages may not sum to 100% due to rounding.

* \$15 Price point is a seasonal (holiday) game.

** Through December, 2010.

Ten years ago, six of the Lottery's 53 instant scratch games were higher price point games (\$5 and up). In FY 11 the Lottery anticipates introducing 66 new games, 24 at the \$5 price point and up.



**WISCONSIN
LOTTERY**

(Table 5). While the payout percentage declined in FY 10 to 64.25%, overall instant scratch prize payout in FY 11 is designed to increase to 64.88% as a result of continued strong sales at higher price points combined with incremental sales from new products at the \$20 price point. In FY 12, the Lottery estimates instant scratch prize payout to remain stable at 64.88%.

Table 5. Historical Perspective: Number of New Game Launches

Price Point	FY 01 Number of Games	FY 08 Number of Games	FY 09 Number of Games	FY 10 Number of Games	FY 11 Number of Games*	FY 12 Anticipated No. of Games
\$1	31	18	16	15	15	15
\$2	14	20	17	15	15	15
\$3	2	14	11	13	12	12
\$5	5	12	14	13	14	14
\$10	1	4	5	6	6	6
\$15	0	0	1	1	1	1
\$20	0	2	1	2	3	4
Total Number of Games	53	70	65	65	66	67
Average Prize Payout	62.97%	64.86%	64.23%	63.28%	64.88%	64.88%

*Based on Launch Schedule 1/5/11.

** Based on planned or actual payout.

Although the trend in Wisconsin and nationally is away from the \$1 price point, the \$1 ticket has the greatest profit margin of any instant ticket. Consequently, the Lottery plans to introduce a sufficient number of lower price point games to meet player demand and keep the games fresh and exciting (Table 6).

Table 6. Wisconsin Lottery's Plan for Fiscal Year 2012

Price Point	Number of Scratch Games	Average Prize Payout Rate
\$1	15	59.00%
\$2	15	62.00%
\$3	12	63.00%
\$5	14	64.50%
\$10	6	70.0%
\$15	1	72.00%
\$20	4	74.00%
Average Total Prize Payout	--	64.88%

The Wisconsin Lottery's planned prize payout is lower than the lottery industry's average at all price points (Table 7). Average instant payout rates in the industry have held fairly stable overall during the

past year. The average overall planned instant prize payout for U.S. lottery jurisdictions is 67.0% in FY 11. The Wisconsin Lottery planned payout in FY 11 is 64.88%.

The Lottery estimates that the trend towards stronger sales of high price point (higher prize payout) games combined with the savings due to the discontinuation of GLEPS discounting will allow the Lottery to stay within the 64.88% payout percentage previously approved.

Table 7. Average Payout Rate by Price Point

Price Point	U.S. Lotteries' FY 11 Average Payout Rate by Price Point*	Wisconsin's FY 11 Plan
\$1	60.5%	59.0%
\$2	64.4%	62.0%
\$3	65.8%	63.0%
\$5	68.7%	64.5%
\$10	72.2%	70.0%
\$20	74.2%	74.0%
\$30	73.7%	NA

*Source: La Fleur's Magazine, July/August, 2010

Pulltab Market Trends and Prize Payout

Wisconsin Lottery pulltab ticket sales decreased \$1.0 million in FY 10. Total sales were \$3.9 million in FY 10 and \$4.9 million in FY 09. For-profit retailer sales were \$2.3 million in FY 10 and \$3.2 million in FY 09. Nonprofit sales were \$1.6 million in FY 10 and \$1.7 million in FY 09.

At one time, when the Lottery was the exclusive vendor of pulltabs in the state, the Lottery had annual pulltab sales of over \$20 million. The Lottery's market share has been eroded by private vendors operating illegally or under sec. 100.16(2), Wis.Stats., a law designed to allow limited-term games of chance by retailers (e.g. McDonald's Monopoly game). Moreover, the playing field is uneven. Private vendors can offer retailers a higher commission; the Lottery's commission is fixed by law. The erosion of the Lottery's pulltab business will continue unless judicial or legislative remedies occur to reduce or stop pulltab sales by private vendors⁵.

The Lottery sells two types of pulltabs. Validation coded pulltabs can be cashed at any retailer. Standard pulltabs can be cashed only at the point of purchase. Validation coded pulltab tickets accounted for 53% of FY 10 pulltab sales. Standard pulltab tickets accounted for 47% of FY 10 sales.

Seven new pulltab games will be launched in FY 11. Six of these games will be offered to for-profit and nonprofit retailers. One will be offered only to nonprofit retailers. The six new games offered to for-profit and nonprofit retailers will have payouts ranging from 61.9% to 65.4%. The average of the payouts for these six new games is 63.08%. The one new game offered only to nonprofit retailers will have a 69.8% payout.

⁵ For additional discussion of this issue see the November 2008 audit of the Lottery conducted by the Legislative Audit Bureau, Report 08-13, pp. 22-24.



Lotto Game Market Trends and Prize Payout

The Lottery believes it can manage the lotto product line at this time without a significant change to prize payout in the coming fiscal year.

The prize payout ratios for lotto games averaged 48.24% in FY 10, ranging from 46.64% (Super-Cash!) to 52.24% (Megabucks). Table 8 lists the lotto games and associated designed prize payouts that are currently offered in Wisconsin. Actual prizes paid, as a percentage of sales, may be less than the designed prize payout for several reasons, such as winners not claiming their prizes. Prizes paid, as a percentage of sales, may also be more than the designed prize payout due to the random nature of game drawings.

Table 8
Lotto Games and Corresponding Start Dates and Prize Payout Rates*

Lotto Games	Start Date	Designed Payout*
Powerball	4/19/92	Approx. 50.00%
Megabucks	6/18/92	53.50%
EZ Match	4/3/11	63.15%
SuperCash!	2/4/91	52.8%
Daily Pick 4	9/15/97	Approx. 48.40%
Daily Pick 3	9/21/92	48.20%
Badger 5	2/17/03	50.00%
Mega Millions	1/31/10	50.00%
Special Draw**	3/4/07	50.00%

* Reflects anticipated rate based on game design.

**No Special Draw game was offered in FY 10, but two will be offered in FY 11.

Traditionally, the prize payout for lotto games has been lower than that for instant scratch games. The primary appeal of lotto games is the chance to win significantly larger prizes, including jackpot prizes worth hundreds of millions of dollars.

In response to qualitative and quantitative research, the Wisconsin Lottery is implementing a new lotto game feature for Megabucks called EZ Match. This feature allows players to win instantly on a Megabucks lotto ticket that is also valid for a regular drawing. Because of the instant win feature, the EZ Match prize payout is more similar to a scratch ticket than to other lotto games. However, the prize payout on the combined product is still less than 60%.

The primary elements of the lotto game strategy continue as in the last several years to be: 1) to refresh or offer additional value on current games through permanent game changes and limited time offers, 2) to support play by offering greater frequency of wins on games with lower top prizes, thereby increasing the number of prizes awarded and 3) to offer new products when possible and profitable. The Lottery continues to develop this strategy in an effort to strengthen the overall game mix into FY 12.



Limited time offers continue to be successful at maintaining product freshness while avoiding the expense of time, effort and budget that is needed to launch a new game. Some offers may slightly increase the prize payout for a limited period of time, but their effect on the game's total prize payout is minimal and closely monitored.

Impact of Prize Payout on Operating Costs

Prize Payout has had little effect on operating costs. Gross revenues increased in FY 10 to \$480,939,257 from \$473,414,254 in FY 09. Total administrative expenditures as determined in accordance with sec. 25.75(3)(b), Wis. Stats. declined during that period from \$33,006,850 (unaudited) to \$32,077,069 (preliminary). These amounts represent 6.9% of gross lottery revenues in FY 09 and 6.6% of gross lottery revenues in FY 10--well within the 10% limitation set by statute.

Furthermore, the Wisconsin Lottery continues to operate at highly efficient levels relative to other jurisdictions. Per capita expenses in Wisconsin are the sixth lowest among 43 United States lotteries, as illustrated by Exhibit 1.

SUMMARY AND RECOMMENDATION

The Wisconsin Lottery continues to improve its game mix in all product categories. Consistent with national trends, the introduction of higher price points to the instant scratch game mix has proved to be a successful strategy. The Lottery will continue to emphasize these higher price point products.

Lotto game sales are expected to decrease slightly in FY 11, although games in the daily lotto category will generate relatively stable sales through FY 12. Lotto products will continue to be refreshed through the use of limited time offers.

For FY 12, the Lottery has designed an overall prize payout of 58.66%, in line with the projected payout of 58.67% in FY 11, but higher than the unusually low payout of 56.78% in FY 10:

- Instant scratch prize payout is 64.88%, to meet consumer demand for \$5, \$10 and \$20 tickets.
- Pulltab payout is 63.46% to allow for new product offerings.
- Lotto game payout remains at 50.39%.

Despite the current economic downturn, the Lottery is confident that sales are stabilizing in FY 11. The Lottery continues to work diligently to maximize funds available for property tax relief and the proposed prize payouts will result in significant revenues for that purpose.



Exhibit 1

Fiscal 2009 U.S. Lottery Per Capita Administrative Expenses

	Lottery	Pop.1 (Mil) ¹	Expense ²	Expense Per Cap
1	Oklahoma	3.7	13.78	3.74
2	California	37.0	188.08	5.09
3	W. Virginia	1.8	9.44	5.19
4	N. Dakota	0.6	3.70	5.73
5	N. Carolina	9.4	54.73	5.83
6	Wisconsin	5.7	33.00	5.84
7	Missouri	6.0	36.54	6.10
8	Arizona	6.6	42.85	6.50
9	Washington	6.7	43.50	6.53
10	S. Dakota	0.8	5.53	6.81
11	Colorado	5.0	35.04	6.97
12	Louisiana	4.5	31.33	6.98
13	New Mexico	2.0	14.17	7.05
14	Florida	18.5	131.10	7.07
15	Kansas	2.8	20.69	7.34
16	Oregon	3.8	28.30	7.40
17	Minnesota	5.3	39.95	7.59
18	Texas	24.8	194.37	7.84
19	Indiana	6.4	50.90	7.93
20	Tennessee	6.3	50.23	7.98
21	Idaho	1.5	12.47	8.07
22	Montana	1.0	8.07	8.28
23	New Jersey	8.7	72.50	8.33
24	Nebraska	1.8	15.14	8.43
25	Illinois	12.9	113.26	8.77
26	R. Island	1.1	9.36	8.89
27	Virginia	7.9	73.71	9.35
28	S. Carolina	4.6	42.96	9.42
29	Kentucky	4.3	42.14	9.77
30	Iowa	3.0	30.75	10.22
31	Maryland	5.7	59.37	10.42
32	Pennsylvania	12.6	132.64	10.52
33	Ohio	11.5	124.29	10.77
34	Michigan	10.0	110.47	11.08
35	N. Hampshire	1.3	16.79	12.67
36	New York	19.5	257.62	13.18
37	Connecticut	3.5	48.10	13.67
38	Vermont	0.6	8.51	13.69
39	Georgia	9.8	140.19	14.26
40	Maine	1.3	19.30	14.64
41	Massachusetts	6.6	99.60	15.10
42	Delaware	0.9	13.63	15.49
43	D.C.	0.6	33.25	55.42
	Total	288.5	2,511.4	8.71

Fiscal year ends June 30 except New York (March 31), Texas (August 31) and D.C. and Michigan (Sept. 30).

¹ Source: U.S. Census Bureau;

² Traditional lottery expenses only;

Source: La Fleurs 2010- World Lottery Almanac



Appendix A
The Relationship Between Guaranteed Low End Prize
Structure Discounting And Prize Payout

Early on in the lottery industry, lottery tickets could only be redeemed by the retailer that sold the tickets. Rather than bill a retailer for the full amount of the pack, and then later crediting the retailer for tickets redeemed, it was thought to be more favorable for the retailer and less burdensome for the lottery to discount the low end prizes (under \$50) that occurred in every pack that would be redeemed by every retailer. The concept of discounting Guaranteed Low End Prize Structure (GLEPS) tickets was born.

Under the GLEPS discounting system, the Wisconsin Lottery billed the retailer for a pack of tickets in the following manner:

Name of Game:	Crossword	-\$3
Pack Size:	100	
Cost of Pack:	\$300	
Amount of GLEPS:	\$173	
Net Cost to Retailer:	\$127¹	

The GLEPS discount was of greater benefit to the retailer than the Lottery. The GLEPS discount assumed that all of the GLEPS prizes (in this example \$173), would be redeemed by the retailer. However, not all Lottery prizes, especially low end prizes are redeemed. Tickets are lost, destroyed in the laundry and winners from out of state do not always find it worthwhile to redeem their prize. An unclaimed prize was a windfall to the retailer as the Lottery reimbursed the retailer for more prizes than were actually claimed.

The amount of benefit to the retailers was significant. The GLEPS prizes in Ninja 9's, a current \$1 game, are \$1,075,200 or 95% of all of the prizes in the game. The Lottery launches about 70 games per year; even a small percentage of prizes that are unclaimed add up to a large amount. In 2003, the Lottery estimated that the total amount of unclaimed prizes to be \$4.7 million.

GLEPS discounting ended in January 2008. Today, retailers get billed for a pack of tickets in the following manner:

Name of Game:	Crossword	-\$3
Pack Size:	100	
Cost of Pack:	\$300	
Net Cost to Retailer:	\$300²	

¹ The retailer commission, currently 6.25%, was also discounted but is, in the interest of simplicity, omitted here.

² The retailer commission is omitted.



The Lottery's accountants account for scratch ticket sales in the same manner. The Lottery uses the accrual method of accounting: when a pack of tickets is sold, the sales are recorded as income and the prizes accrued as an expense based on a percentage of sales. Using the first week of sales of Ninja 9's, which has a 59% prize payout as an example, a simple balance sheet might look like this:

Revenues	
Ninja 9's	<u>\$630,600.00</u>
Expense	
Ninja 9's GLEPS Prize Expense	\$353,451.30
Ninja 9's High Tier Prize Expense	<u>\$ 18,602.70</u>
Total Expenses	<u>\$372,054.00</u>
Net Income	<u>\$258,546.00</u>

Currently, at the end of the game all unclaimed prizes operate as a credit against the expenses. In other words, the accrued prize expense is reduced by unclaimed (and therefore, unpaid) prizes.

Under GLEPS discounting, the unclaimed GLEPS prizes operated as a windfall to the retailer and were never used to reduce the Lottery's prize liability. The GLEPS prizes in the Ninja 9 game make up almost 95% of the total prizes. Thus, the windfall to retailers was significant. With the end of GLEPS discounting, all the money from unclaimed GLEPS prizes is credited to the Lottery, increasing the Lottery's net income.

While the improvement to the Lottery's bottom line is certainly welcome, the end of GLEPS discounting presents a problem in estimating the actual prize payout. As noted above, money from unclaimed GLEPS prizes is credited to the Lottery reducing the previously incurred GLEPS prize expense. The problem is that the unclaimed prizes credit is not accounted for until after the time for claiming prizes has expired, which can be over a year after sales have ended and after the fiscal year is ended. With this new way of doing business, the Lottery's projections for prize payout will not be, at least for the near future, as precise as they have been in the past.

